L’utilisation et l’optimisation de pertes et d’attributs fiscaux

Le jeudi 27 mars 2014; Montréal

2014

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Le 27 mars 2014, Montréal

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Valuation of tax attributes of acquired business entities and of "loss companies"

VALUATOR'S JUDGMENT: SELECTED "ABOVE-THE-LINE" FACTORS"

- Valuation approach
- Valuation methods and techniques under the approach
- Adjustments made to "normalize" accounting figures per financial statements
- Redundant assets
- "Off-balance sheet" items
- "Trapped-in" (embedded) capital gains
- Valuing RDTOH

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- 1 -

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VALUATOR'S JUDGMENT: SELECTED "BELOW-THE-LINE" FACTORS"

- Valuation methodology for minority shares:
  - Top down
  - Bottom up
  - Comparison with other private-company minority transactions (but data rarely available)
- If minority shares of holding company, can shareholder cause liquidation?
- Personal income taxes — if RDTOH included in fair market value of corporation

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- 2 -

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ABC CORPORATION

LOSS OF TAX SHIELD — ASSETS vs. SHARES

Fair market value of building	$ 900,000
Undepreciated capital cost	$ 230,000

Tax shield if assets purchased:

$$\frac{\text{Fair Market Value} \times \text{Tax Rate} \times \text{CCA Rate}}{\text{Rate of Return} + \text{CCA Rate}} \times \left[1 - \frac{\text{Rate of Return}}{2 \times (1 + \text{Rate of Return})}\right]$$

$$\frac{\$900{,}000 \times 45\% \times 4\%}{8\% + 4\%} \times \left[1 - \frac{8\%}{2 \times (1 + 8\%)}\right] \qquad \$\ 130{,}000$$

Tax shield if shares purchased:

$$\frac{\text{UCC} \times \text{Tax Rate} \times \text{CCA Rate}}{\text{Rate of Return} + \text{CCA Rate}}$$

$$\frac{\$230{,}000 \times 45\% \times 4\%}{8\% + 4\%} \qquad 34{,}500$$

LOSS OF TAX SHIELD		$ 95,500
	Rounded	$ 96,000

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$$\frac{\$900{,}000 \times 45\% \times 4\%}{10\% + 4\%} \times \left[1 - \frac{10\%}{2 \times (1 + 10\%)}\right] \qquad \$\ 110{,}454$$

Tax shield if shares purchased:

$$\frac{\text{UCC} \times \text{Tax Rate} \times \text{CCA Rate}}{\text{Rate of Return} + \text{CCA Rate}}$$

$$\frac{\$230{,}000 \times 45\% \times 4\%}{10\% + 4\%} \qquad 29{,}571$$

LOSS OF TAX SHIELD		$ 80,883
	Rounded	$ 81,000

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ABC CORPORATION

TAX SHIELD ON PROJECTED ANNUAL CAPITAL EXPENDITURES

		2014	2015	2016	2017	2018
Annual capital expenditures		$2,740,000	$2,242,000	$2,309,000	$2,379,000	$2,450,000
LESS: Tax shield thereon						
CCA rate*	42.41%					
Rate of return, after-tax	25.57%					
Present value of tax benefit**		(494,000)	(403,000)	(415,000)	(428,000)	(440,000)
Annual capital expenditures (net of tax shield)		$2,246,000	$1,839,000	$1,894,000	$1,951,000	$2,010,000

* Based on weighted average of UCC tax balances and company's high proportion of IT-related investments.

** Tax shield = $\frac{\text{SCR} \times \text{Tax Rate} \times \text{CCA Rate}}{\text{CCA Rate} + \text{Discount Rate}} \times \left[1 - \frac{\text{Discount Rate}}{2 \times (1 + \text{Discount Rate})}\right]$

Valuation of tax attributes of acquired business entities and of "loss companies"

CONSIDERATIONS OF PURCHASER — GENERAL

Fair Market Value assumes notional transaction and both purchaser and vendor ultimately find areas of compromise and agreement. Purchaser of issued shares of holding company is indirectly acquiring its underlying assets and liabilities. Price to be paid is function of attractiveness of such assets to the purchaser (as well as any financing in place).

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LATENT INCOME TAXES AND SELLING COSTS ACCRUED AND UNREALIZED TAXABLE CAPITAL GAINS

- Disposition costs and income taxes on company's assets are factored into valuation of its issued shares.
- Two alternatives:
  - *Full cost approach* — considering all costs and taxes that would be incurred in a notional, orderly, wind-up of the corporation; and
  - *Partial cost approach* — discounting costs and taxes assuming that purchaser of shares could defer the payment of certain costs and taxes. (If latter approach, focus must include consideration of tax-affected financial statement to ensure adequate rate of return is generated on adjusted equity employed.)

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- 7 -

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LATENT INCOME TAXES AND SELLING COSTS ACCRUED AND UNREALIZED TAXABLE CAPITAL GAINS (CONT'D)

In valuing shares of Holdco, consideration given to:

a. *Costs of disposition of assets* — selling costs generally vary with selling price and will increase as value increases. Must consider (i) it may take significant time to dispose of the assets, and (ii) the time-value of money, risk -affected.
b. *Income taxes on notional sale of assets*, major negotiating points being:
   1. If assets notionally sold, full taxes and disposition costs recognized, including consideration of income vs. capital treatment for tax purposes;
   2. If assets held rather than sold, taxes deferred and therefore discounted;
   3. If assumption is that assets are held, then cash flows generated by the assets also taken into account (rather than only values of individual assets, viewed in isolation).

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- 8 -

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LATENT INCOME TAXES AND SELLING COSTS ACCRUED AND UNREALIZED TAXABLE CAPITAL GAINS (CONT'D)

c. *Liquidation risk* — purchaser would assess risk relative to realizing market values of underlying assets, including consideration of contingent liabilities and such unknowns as environmental issues from ownership, and require a return over and above simple time-value of money in order to assume the risks inherent in liquidation process.

d. *Costs and taxes exigible on winding-up* of corporation and respective views of vendor and purchaser of corporation's shares.

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VALUATION OF HOLDCO SHARES

	Alternative Premises			
	Holdco Continues		Holdco Liquidates	
FMV of building	$1 500 000		$1 500 000	
Loss of tax shield, say	300 000	*		
Recapture of CCA			500 000	
Cash available	1 200 000		1 000 000	
Personal tax on distribution, say	100 000	**	220 000	***
	$1 100 000		$ 780 000	

* $\dfrac{\text{Cost x tax rate x CCA rate}}{\text{After-tax rate of return + CCA rate}}$

** Present value of personal tax on taxable dividends over a number of years (present value).

*** Personal tax payable upon immediate withdrawal of surplus.

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RDTOH IN SHARE VALUATION

If RDTOH is to be included in the value of shares, and such value can only be realized (and included in corporate worth) if taxable dividends are paid, buyer will take this into account and discount price for the shares because of personal taxes on such dividends. Therefore, if additional corporate value is recognized because of potential receipt by company of RDTOH, and such receipt is contingent upon, and inextricably linked to, payment of taxable dividends, personal income taxes must be considered in determining price buyer would pay for the shares and, hence, impacts value of company's shares.

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"RULE OF THUMB" — SELECT OBSERVED EXAMPLES OF TRANSACTIONS INVOLVING NON-CAPITAL LOSSES

Price Paid per $ of Loss	Corporate Tax Rate	Price Paid per $ of Tax Saving
$0,030	28,40%	$0,106
$0,035	26,90%	$0,130
$0,040	29,90%	$0,134
$0,045	33,05%	$0,136
$0,050	33,05%	$0,151
$0,055	33,16%	$0,166
$0,050	28,40%	$0,176

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IMPLIED VALUE OF NON-CAPITAL LOSSES

Year	Projected Taxable Income	Non-Capital Losses Available	Assumed Tax Savings @ 26.9%	PV of Tax Savings @ 60%	PV of Tax Savings @ 70%	PV of Tax Savings @ 80%
	-	10 000 000	-		-	
1	850 000	9 150 000	228 650	143 264	134 806	127 311
2	892 500	8 257 500	240 083	94 253	83 452	74 430
3	937 125	7 320 375	252 087	62 008	51 661	43 514
4	983 981	6 336 394	264 691	40 795	31 981	25 440
5	1 033 180	5 303 213	277 926	26 839	19 798	14 873
6	1 084 839	4 218 374	291 822	17 657	12 256	8 695
7	1 139 081	3 079 293	306 413	11 617	7 587	5 083
8	1 196 035	1 883 257	321 734	7 642	4 697	2 972
9	1 255 837	627 420	337 820	5 028	2 908	1 738
10	1 318 629		168 776	1 574	856	483
			2 690 000	**410 678**	**350 002**	**304 539**

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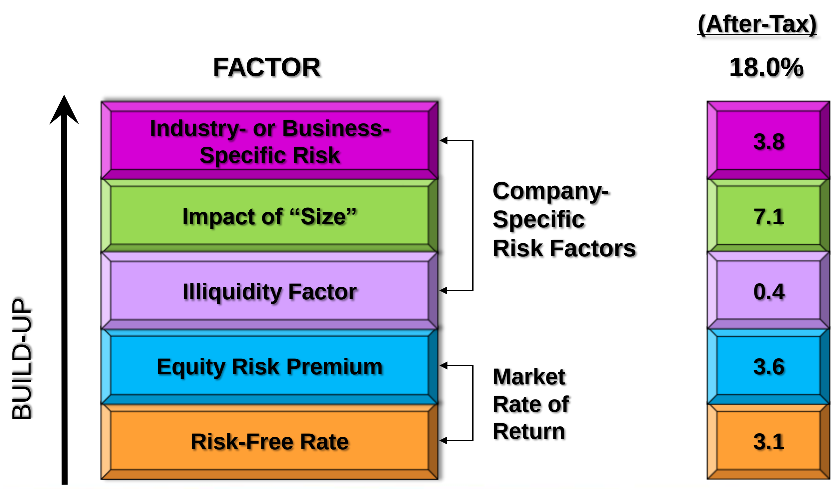
DEVELOPING RATE OF RETURN (DISCOUNT RATE OR CAPITALIZATION RATE)

"BUILD-UP METHOD" — EXAMPLE

(Rates for illustrative purposes only.)



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VALUING NON-CAPITAL LOSSES

- **Rule of thumb $0.012 to $0.030 per $1 of losses**
- ***Example*: BA Energy Inc., Orderly Liquidation Value as at February 26, 2010, had approximately $605 million tax losses, valued by liquidators at $0.025 to $0.03.**